

CALIFORNIA HOUSING FINANCE AGENCY

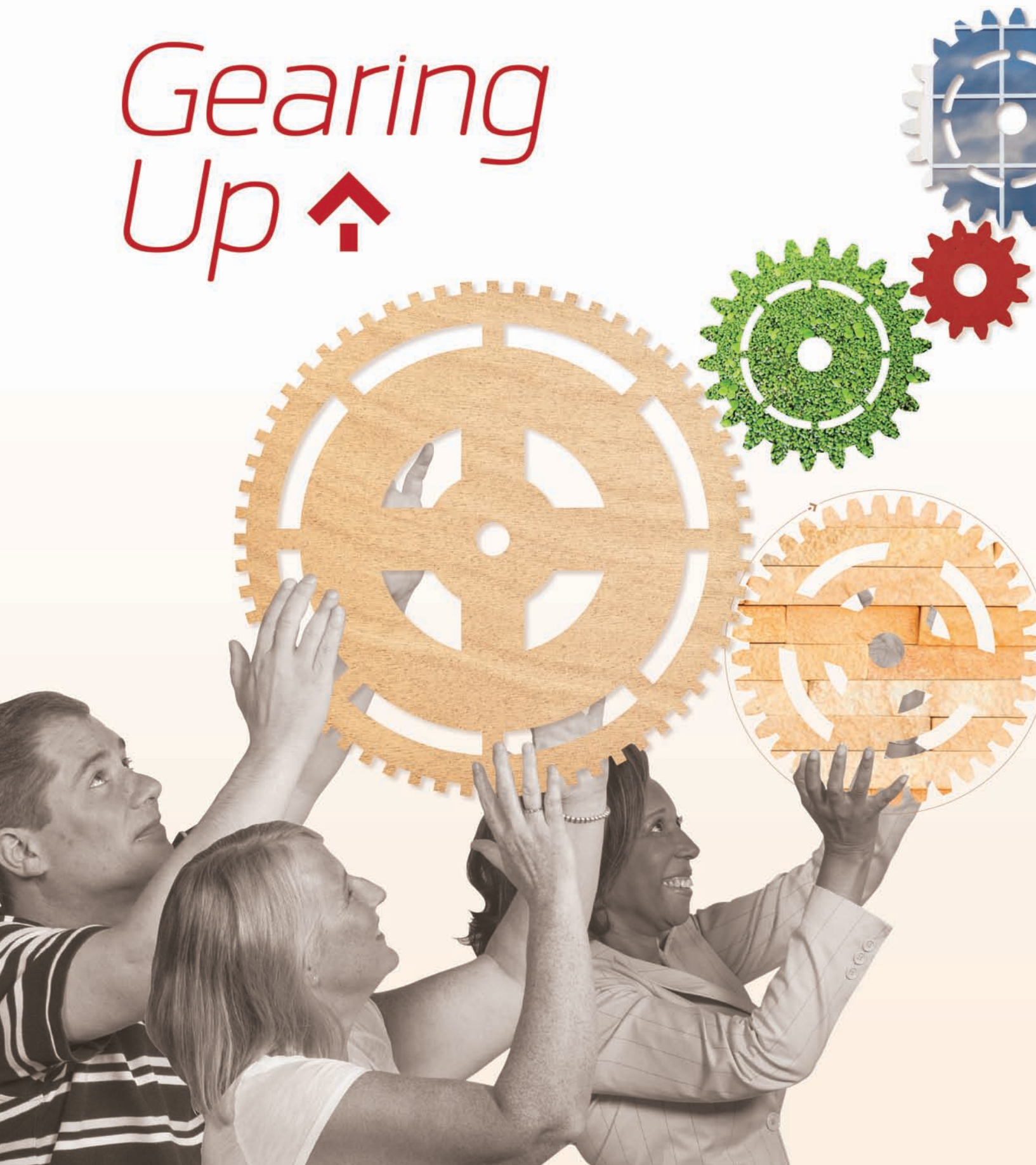
California Housing Loan Insurance Fund

AUDITED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011



Gearing Up



**CALIFORNIA HOUSING
LOAN INSURANCE FUND
Sacramento, California**

**FINANCIAL STATEMENTS,
SUPPLEMENTARY INFORMATION, AND
INDEPENDENT AUDITOR'S REPORT
Years Ended December 31, 2012 and 2011**

Independent Auditors' Report

Board of Directors
California Housing Finance Agency
Sacramento, California

Report on the Financial Statements

We have audited the accompanying financial statements of the California Housing Loan Insurance Fund (the Fund), which is administered by the California Housing Finance Agency (the Agency), a component unit of the State of California, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the entity's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of December 31, 2012 and 2011, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Fund will continue as a going concern. As discussed in Note 2 to the financial statements, the Fund is experiencing difficulty in generating sufficient cash flow to meet its obligations and sustain its operations. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to that matter.

Other Matters***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 - 10 are presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.



CliftonLarsonAllen LLP

Baltimore, Maryland
April 25, 2013

CALIFORNIA HOUSING LOAN INSURANCE FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS YEARS ENDED DECEMBER 31, 2012 AND 2011

The California Housing Finance Agency (the "Agency") was created in 1975 by an act of the California Legislature and commenced operations in 1976. The Agency is a component unit of the State of California (the "State") and is included in the State's Comprehensive Annual Financial Report. The Agency is authorized to administer the activities of the California Housing Loan Insurance Fund (the "Fund"), the California Housing Finance Fund ("CHFF"), and two State general obligation bond funds. The following Management Discussion and Analysis applies only to the activities of the California Housing Loan Insurance Fund and should be read in conjunction with the Fund's financial statements and the notes to the financial statements. The Agency is entirely self-funded and does not draw upon the general taxing authority of the State. Last year, the Governor introduced a wide-ranging government reorganization plan in order to improve efficiencies in state government. As part of the Governor's Reorganization plan, the Agency will transfer into the Department of Housing and Community Development and will be under the umbrella of the newly created Business, Consumer Services and Housing Agency effective July 1, 2013. It is not anticipated that the proposed changes will affect the Agency's statutory independence. The Agency is authorized to use the Fund's assets as at-risk capital in support of mortgage insurance programs which finance the acquisition, new construction, or rehabilitation of residential structures in California. The Fund insures loans made by the Agency; loans made by lenders for securitization by the Federal National Mortgage Association ("FNMA"), and Federal Home Loan Mortgage Corporation ("FHLMC"); and loans made by localities, nonprofit agencies, and the California State Teachers' Retirement System. In conducting business the Agency is authorized to reinsure any risk undertaken by the Fund.

While the Fund is subject to the same statutory requirements as private mortgage insurance companies with respect to the maintenance of policyholders' surplus, the Fund is exempt from regulatory control by the State Department of Insurance. The Fund is currently unrated.

Underwriting, acquisition, and issuance expenses are charged directly to the Fund as well as loss and loss adjustment expenses. Certain administrative and operating expenses, including office space, business services and supplies, legal services, accounting services, information technology support, and human resource support services, are provided by the Agency and indirectly charged to the Fund. The basic financial statements of the Fund include the statement of net position, statement of revenue, expenses and changes in net position and statement of cash flows.

FINANCIAL RESULTS 2012 – 2011

- Insurance in force decreased by \$365.5 million, or 19.9 %, to \$1.47 billion as of December 31, 2012, compared to \$1.84 billion as of December 31, 2011. The Fund ceased committing to insure new loans in September 2009.
- The Fund had an operating loss of \$19.4 million for 2012. Net operating results of the Fund decreased by approximately \$21 million in 2012 compared to the operating income of \$1.6 million in 2011. This was primarily due to losses incurred during 2012 and the \$4.2 million increase to the Premium Deficiency Reserve during 2012. The Fund has a net deficit balance of \$111.2 million at December 31, 2012, compared to a net deficit balance of \$91.8 million at December 31, 2011.

- The number and amount of insured delinquencies declined from 1,278 or \$356 million in 2011 to 999 or \$276.8 million in 2012. Gross insurance claim payments were \$99.6 million and \$149.8 million in 2012 and 2011, respectively, before reinsurance.
- The Fund's reserve for loan losses decreased by \$8 million in 2012 to \$27.6 million as a result of the Fund's decreased number of delinquencies outstanding. The Agency continues to monitor delinquencies closely and is proactive in its attempts to mitigate losses.
- The Fund continued the reinsurance treaty and administrative services agreement with Genworth Financial ("Genworth"), previously known as GE Mortgage Insurance Corporation ("GEMICO"). This insurance treaty cedes to Genworth a 75% quota share of the insurance risk and 64.5% of the premium collected for most loans insured by the Fund. The treaty was amended for loans insured on or after May 1, 2008 to 67% of premium collected and amended again on April 1, 2009 to 69% of premium collected on loans insured on or after that date.
- Each month, the Fund continues to receive its share of premiums from policies still in force and uses the monthly premiums received along with any other available funds to pay the Fund's claims on a "first-in, first-out" basis in the order in which the claims are received after paying the monthly operating expenses of the Fund (see Note 2). The Fund continues to remain dependent upon the ability of the Fund's reinsurer to pay its share of the claims. (see Note 5).
- During 2012, Moody's Investor Services ("Moody's") rating of Genworth remained unchanged at "Ba1" and Standard and Poor's ("S&P") rating of Genworth remained unchanged at "B".

2012 COMPARED TO 2011

CONDENSED STATEMENTS OF NET POSITION

The following table presents condensed statements of net position for the Fund as of December 31, 2012 and 2011, and the change from year to year (dollars in thousands):

	2012	2011	Change
ASSETS			
Cash, cash equivalents, and investments	\$ 208	\$ 170	\$ 38
Other assets	<u>946</u>	<u>1,197</u>	<u>(251)</u>
Total assets	<u>\$ 1,154</u>	<u>\$ 1,367</u>	<u>\$ (213)</u>
LIABILITIES			
LIABILITIES:			
Unpaid losses and loss adjustment expenses	\$ 27,577	\$ 35,591	\$ (8,014)
Premium deficiency reserve	49,849	45,643	4,206
Unearned premiums	75	119	(44)
Accounts payable and other liabilities	<u>34,846</u>	<u>11,803</u>	<u>23,043</u>
Total liabilities	<u>112,347</u>	<u>93,156</u>	<u>19,191</u>
NET POSITION:			
Invested in capital assets	18	23	(5)
Unrestricted	<u>(111,211)</u>	<u>(91,812)</u>	<u>(19,399)</u>
Total net position	<u>(111,193)</u>	<u>(91,789)</u>	<u>(19,404)</u>

Assets - Total assets of the Fund were \$1.2 million as of December 31, 2012, a decrease of \$0.2 million or 16% from December 31, 2011. Of the Fund's assets, 18% are represented by cash and investments. The Fund does not have a significant investment in capital assets.

Cash, cash equivalents, and investments were \$208 thousand as of December 31, 2012, an increase of \$38 thousand from December 31, 2011. The Agency invests the Fund's cash in the State's Surplus Money Investment Fund ("SMIF"). SMIF provides the Fund a variable rate of return and complete liquidity. Cash invested in SMIF is deposited within the State's Centralized Treasury System and managed by the State Treasurer.

Other assets were \$946 thousand as of December 31, 2012, a decrease of \$251 thousand or 21% from December 31, 2011. The decrease is primarily due to having a lower accounts receivable from Genworth as the number of active policies has declined.

Liabilities - The Fund's liabilities were \$112.3 million as of December 31, 2012, an increase of \$19.2 million or 21% from December 31, 2011.

The reserve for unpaid losses and loss adjustment expenses was \$27.6 million as of December 31, 2012, a decrease of \$8 million from December 31, 2011. However, the premium deficiency reserve increased \$4.2 million to \$49.8 million in 2012. As of December 31, 2012, 1099 insured loans with balances aggregating \$304.5 million were either reported as delinquent by the lender or assumed delinquent but not reported. As of December 31, 2011, 1406 insured loans with balances aggregating \$391 million were either reported as delinquent by the lender or assumed delinquent but not reported.

Unearned premiums were \$75 thousand as of December 31, 2012, a decrease of \$44 thousand from December 31, 2011. The decrease was due to policy adjustments between the servicer and reinsurer. The expected trend of this account is to decrease over time due to a change in premium collection practices. Beginning in 1996, management adopted the mortgage insurance industry norm of collecting monthly premium payments in arrears for newly established loan insurance products as compared to past practices of collecting annual premiums in advance. As a result, each year a greater percentage of insured loans require monthly premium payments, which are earned when received, rather than annual payments, which are received in advance and deferred and earned over a one-year period.

Accounts payable and other liabilities were \$34.8 million as of December 31, 2012, an increase of \$23 million from December 31, 2011. This increase is due to the change in claim payments process by Genworth and the increase in unpaid claims. Genworth is only paying their share of 75% claim payment and the Fund is paying 25% share of the claim payment. Also, the Fund's cash is temporarily depleted each month so an accounts payable was set up for CaHLIF's share of the claim payments that have not yet been paid.

Net Position - The Fund's net position are classified as unrestricted or invested in capital assets. Total net position of the Fund decreased by \$19.4 million as a result of this current year's operations.

CONDENSED STATEMENTS OF REVENUES AND EXPENSES

The following table presents condensed statements of revenues and expenses for the Fund for the years ended December 31, 2012 and 2011, and the change from year to year (dollars in thousands):

	2012	2011	Change
OPERATING REVENUES:			
Premiums earned	\$ 10,683	\$ 12,914	\$ (2,231)
Investment income	-	37	(37)
Other revenues	1	4	(3)
Total operating revenues	<u>10,684</u>	<u>12,955</u>	<u>(2,271)</u>
OPERATING EXPENSES:			
Loss and loss adjustment expenses	17,895	25,066	(7,171)
Premium deficiency reserve expenses	4,206	(22,983)	27,189
Operating expenses	7,876	9,380	(1,504)
Other expenses	111	(80)	191
Total operating expenses	<u>30,088</u>	<u>11,383</u>	<u>18,705</u>
OPERATING INCOME(LOSS)	<u>\$ (19,404)</u>	<u>\$ 1,572</u>	<u>\$ (20,976)</u>

Operating Revenues - Operating revenues were \$10.7 million during 2012 compared to \$13.0 million during 2011, a decrease of \$2.3 million or 18%.

Premiums earned in 2012 decreased by \$2.2 million or 17% compared to premiums earned in 2011. The decrease in premiums earned corresponds with the decrease in insurance in force. Insurance in force was \$1.5 billion and \$1.8 billion as of December 31, 2012 and 2011, respectively.

Investment income decreased to \$77 dollars in 2012 from \$37 thousand in 2011. This decrease was due to the decrease in interest rates and decrease in investment in SMIF. SMIF interest rates for the past two years are shown in the following table:

Interest Payment Periods	Fiscal Year 2012	Interest Payment Periods	Fiscal Year 2011
January — March	0.374%	January — March	0.508%
April — June	0.361%	April — June	0.480%
July — September	0.349%	July — September	0.377%
October — December	0.316%	October — December	0.378%

Other revenues decreased by \$3 thousand to \$1 thousand in 2012 from \$4 thousand in 2011. Recoveries made on amounts owed from defendants in certain litigation decreased from last year.

Operating Expenses - Total operating expenses were \$30.1 million during 2012 compared to \$11.4 million during 2011, an increase of \$18.7 million or 164%.

Loss and loss adjustment expenses decreased by \$7.2 million in 2012 while the Premium deficiency reserve expenses increased by \$27.2 million in 2012. The increase in Premium deficiency reserve expenses is attributable to the increase in required reserves to cover potential losses, and claims payable.

The Fund's operating expenses were \$7.9 million during 2012 compared to \$9.4 million during 2011, a decrease of \$1.5 million or 17%. The decrease is primarily a result of lower ceded premiums to the reinsurer due to lower insurance in force.

Operating Loss - Operating loss for 2012 was \$19.4 million compared to operating income of \$1.6 million in 2011, a decrease of \$21 million. The decrease is primary a result of increasing the premium deficiency reserve balance in 2012 rather than decreasing the premium reserve balance as in 2011.

Contact Information - If you would like additional information on the California Housing Loan Insurance Fund, please visit www.calhfa.ca.gov.

2011 COMPARED TO 2010

CONDENSED STATEMENT OF NET POSITION

The following table presents condensed statement of net position for the Fund as of December 31, 2011 and 2010, and the change from year to year (dollars in thousands):

	2011	As Restated 2010	Change
ASSETS			
Cash, cash equivalents, and investments	\$ 170	\$ 28,081	\$ (27,911)
Other assets	<u>1,197</u>	<u>1,019</u>	<u>178</u>
Total assets	<u>\$ 1,367</u>	<u>\$ 29,100</u>	<u>\$ (27,733)</u>
LIABILITIES			
LIABILITIES:			
Unpaid losses and loss adjustment expenses	\$ 35,591	\$ 49,596	\$ (14,005)
Premium deficiency reserve	45,643	68,626	(22,983)
Unearned premiums	119	174	(55)
Accounts payable and other liabilities	<u>11,803</u>	<u>4,065</u>	<u>7,738</u>
Total liabilities	<u>93,156</u>	<u>122,461</u>	<u>(29,305)</u>
NET POSITION:			
Invested in capital assets	23	28	(5)
Unrestricted	<u>(91,812)</u>	<u>(93,389)</u>	<u>1,577</u>
Total net position, as restated	<u>(91,789)</u>	<u>(93,361)</u>	<u>1,572</u>

Assets - Total assets of the Fund were \$1.4 million as of December 31, 2011, a decrease of \$27.7 million or 95% from December 31, 2010. Of the Fund's assets, more than 12% are represented by cash and investments. The Fund does not have a significant investment in capital assets.

Cash, cash equivalents, and investments were \$170 thousand as of December 31, 2011, a decrease of \$27.9 million from December 31, 2010. The decrease is primarily due to an increase in claim payments. The Agency invests the Fund's cash in the State's Surplus Money Investment Fund ("SMIF"). SMIF provides the Fund a variable rate of return and complete liquidity. Cash invested in SMIF is deposited within the State's Centralized Treasury System and managed by the State Treasurer.

Other assets were \$1.2 million as of December 31, 2011, an increase of \$0.2 million or 17% from December 31, 2010. The increase is the result of changing the claim payment process. Genworth is only paying their share of the claim payments and remitted all the premium thus increasing the accounts receivable from Genworth.

Liabilities - The Fund's liabilities were \$93.2 million as of December 31, 2011, a decrease of \$29.3 million or 24% from December 31, 2010.

The reserve for unpaid losses and loss adjustment expenses was \$35.6 million as of December 31, 2011, a decrease of \$14.0 million from December 31, 2010. The decrease in the loss reserve is the result of the Fund's lower loss reserves required to cover potential losses. As of December 31, 2011, 1406 insured loans with balances aggregating \$391 million were either reported as delinquent by the lender or assumed delinquent but not reported. As of December 31, 2010, 1927 insured loans with balances aggregating \$542 million were either reported as delinquent by the lender or assumed delinquent but not reported.

Unearned premiums were \$119,000 as of December 31, 2011, a decrease of \$55,000 from December 31, 2010. The decrease was due to policy adjustments between the servicer and reinsurer. The expected trend of this account is to decrease over time due to a change in premium collection practices. Beginning in 1996, management adopted the mortgage insurance industry norm of collecting monthly premium payments in arrears for newly established loan insurance products as compared to past practices of collecting annual premiums in advance. As a result, each year a greater percentage of insured loans require monthly premium payments, which are earned when received, rather than annual payments, which are received in advance and deferred and earned over a one-year period.

Accounts payable and other liabilities were \$11.8 million as of December 31, 2011, an increase of \$7.7 million from December 31, 2010. This increase is due to the change in claim payments process by Genworth. Genworth is only paying their share of 75% claim payment and the Fund is paying 25% share of the claim payment. Also, the Fund's cash was temporarily depleted during the year so an accounts payable was set up for CaHLIF's share of the claim payment.

Net Position - The Fund's net position are classified as restricted, unrestricted or invested in capital assets. Total net position of the Fund increased by \$1.6 million as a result of the current year operating income.

CONDENSED STATEMENTS OF REVENUES AND EXPENSES

The following table presents condensed statements of revenues and expenses for the Fund for the years ended December 31, 2011 and 2010, and the change from year to year (dollars in thousands):

	2011	As Restated 2010	Change
OPERATING REVENUES:			
Premiums earned	\$ 12,914	\$ 16,502	\$ (3,588)
Investment income	37	255	(218)
Other revenues	<u>4</u>	<u>8</u>	<u>(4)</u>
Total operating revenues	<u>12,955</u>	<u>16,765</u>	<u>(3,810)</u>
OPERATING EXPENSES:			
Loss and loss adjustment expenses	2,083	29,727	(27,644)
Operating expenses	9,380	11,958	(2,578)
Other expenses	<u>(80)</u>	<u>10</u>	<u>(90)</u>
Total operating expenses	<u>11,383</u>	<u>41,695</u>	<u>(30,312)</u>
OPERATING INCOME (LOSS)	<u>\$ 1,572</u>	<u>\$ (24,930)</u>	<u>\$ 26,502</u>

Operating Revenues - Operating revenues were \$13.0 million during 2011 compared to \$16.8 million during 2010, a decrease of \$3.8 million or 23%.

Premiums earned in 2011 decreased by \$3.6 million or 22% compared to premiums earned in 2010. The decrease in premiums earned corresponds with the decrease in insurance in force. Insurance in force were \$1.8 billion and \$2.3 billion as of December 31, 2011 and 2010, respectively.

Investment income decreased \$218,000 to \$37,000 in 2011 from \$255,000 in 2010. This decrease was due to the decrease in interest rates and decrease in investment in SMIF. SMIF interest rates for the past two years are shown in the following table:

Periods	Year 2011	Periods	Year 2010
January — March	0.508%	January — March	0.551%
April — June	0.480%	April — June	0.559%
July — September	0.377%	July — September	0.503%
October — December	0.378%	October — December	0.456%

Other revenues decreased by \$4,000 to \$4,000 in 2011 from \$8,000 in 2010. Recoveries made on amounts owed from defendants in certain litigation increased from last year.

Operating Expenses - Total operating expenses were \$11.4 million during 2011 compared to \$41.7 million during 2010, a decrease of \$30.3 million or 73%.

Loss and loss adjustment expenses decreased by \$27.6 million in 2011. The decrease is attributable to the decrease in required reserves to cover potential losses and premium deficiency reserve.

The Fund's operating expenses were \$9.4 million during 2011 compared to \$12.0 million during 2010, a decrease of \$2.6 million or 22%. The decrease is primarily a result of lower ceded premiums to the reinsurer due to lower insurance in force and a decrease in salary expenses.

Operating Loss - Operating income for 2011 was \$1.6 million compared to \$24.9 million loss in 2010, a decrease of \$26.5 million. The decrease in operating loss is a result of the decrease in loss and loss adjustment expenses.

Contact Information - If you would like additional information on the California Housing Loan Insurance Fund, please visit www.calhfa.ca.gov.

CALIFORNIA HOUSING LOAN INSURANCE FUND

STATEMENTS OF NET POSITION DECEMBER 31, 2012 AND 2011

	2012	2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 195,629	\$ 144,185
Investment in Surplus Money Investment Fund	12,000	26,000
Interest receivable	12	13
Other current assets	<u>932,968</u>	<u>1,179,044</u>
Total current assets	1,140,609	1,349,242
NONCURRENT ASSETS — Other assets	<u>13,553</u>	<u>17,681</u>
Total assets	<u>\$ 1,154,162</u>	<u>\$ 1,366,923</u>
LIABILITIES		
CURRENT LIABILITIES:		
Reserves for unpaid losses and loss adjustment expenses	\$ 27,576,790	\$ 35,591,608
Premium deficiency reserve	49,849,000	45,643,000
Unearned premiums	74,850	118,659
Reinsurance payable	364,839	471,954
Claims payable	33,499,477	10,771,829
Accounts payable and other liabilities	117,861	56,042
Compensated absences	94,546	9,252
Due to other funds	<u>175,051</u>	<u>184,140</u>
Total current liabilities	111,752,414	92,846,484
NONCURRENT LIABILITIES — OPEB	<u>595,000</u>	<u>309,440</u>
Total liabilities	<u>112,347,414</u>	<u>93,155,924</u>
CONTINGENCIES (Note 8)		
NET POSITION		
Invested in capital assets	17,681	22,587
Unrestricted	<u>(111,210,933)</u>	<u>(91,811,588)</u>
Total net position (deficit)	<u>(111,193,252)</u>	<u>(91,789,001)</u>

See notes to financial statements.

CALIFORNIA HOUSING LOAN INSURANCE FUND

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
OPERATING REVENUES		
Premium earned	\$ 10,682,849	\$ 12,913,859
Investment income	77	37,582
Other revenues	<u>900</u>	<u>3,750</u>
Total operating revenues	<u>10,683,826</u>	<u>12,955,191</u>
OPERATING EXPENSES		
Loss and loss adjustment expenses - net of recoveries	17,894,768	25,065,603
Premium deficiency reserve expenses	4,206,000	(22,983,000)
Operating expenses	7,876,511	9,380,104
Other expenses - net	<u>110,798</u>	<u>(79,983)</u>
Total operating expenses	<u>30,088,077</u>	<u>11,382,724</u>
OPERATING(LOSS)/INCOME	(19,404,251)	1,572,467
NET POSITION - Beginning of year	<u>(91,789,001)</u>	<u>(93,361,468)</u>
NET POSITION - End of year	<u><u>\$ (111,193,252)</u></u>	<u><u>\$ (91,789,001)</u></u>

See notes to financial statements.

CALIFORNIA HOUSING LOAN INSURANCE FUND

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	\$ 10,859,056	\$ 12,520,412
Payments to suppliers	15,464,349	(875,611)
Payments to employees	(653,824)	(554,976)
Payment to other government entities	276,471	(10,501)
Other payments	<u>(25,908,687)</u>	<u>(39,066,384)</u>
Net cash provided by (used in) operating activities	<u>37,365</u>	<u>(27,987,060)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of investments	88,000	65,236,000
Purchase of investments	(74,000)	(37,216,000)
Interest on investments	<u>79</u>	<u>76,689</u>
Net cash provided by investing activities	<u>14,079</u>	<u>28,096,689</u>
INCREASE IN CASH AND CASH EQUIVALENTS	51,444	109,629
CASH AND CASH EQUIVALENTS — Beginning of year	<u>144,185</u>	<u>34,556</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 195,629</u>	<u>\$ 144,185</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating income (loss)	\$ (19,404,251)	\$ 1,572,467
Adjustments to reconcile operating income (loss) to net cash used in operating activities:		
Interest on investments	(77)	(37,582)
Unpaid loss and loss adjustment expenses	(8,014,818)	(14,004,532)
Premium deficiency reserve expense	4,206,000	(22,983,000)
Depreciation expense	4,906	5,429
Deferred policy acquisition expense	25,280	115,498
Effects of changes in certain operating assets and liabilities:		
Other assets	220,016	(337,444)
Unearned premiums	(43,809)	(56,003)
Reinsurance payable	(107,114)	(2,928,507)
Compensated absences	85,294	(114,319)
Claims payable	22,727,648	10,771,829
Accounts payable and other liabilities	61,819	19,605
Due to other government entities	<u>276,471</u>	<u>(10,501)</u>
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	<u>\$ 37,365</u>	<u>\$ (27,987,060)</u>

CALIFORNIA HOUSING LOAN INSURANCE FUND

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

1. AUTHORIZING LEGISLATION AND ORGANIZATION

The California Housing Loan Insurance Fund (the “Fund”) is one of two continuously appropriated funds administered by the California Housing Finance Agency (the “Agency”). The Agency was created by the Zenovich-Moscone-Chacon Housing and Home Finance Act, as amended, as a public instrumentality, a political subdivision, and a component unit of the state of California (the “State”), and is in the State’s Annual Financial Report and administers the activities of the Fund and the California Housing Finance Fund (“CHFF”). These funds allow the Agency to carry out its purpose of meeting the housing needs of persons and families of low and moderate income within the State. The Agency is authorized to insure mortgage loans and to issue bonds, notes, and other obligations to fund loans to qualified borrowers for single-family houses and multifamily developments. The Agency has no taxing power and is exempt from federal income taxes and state franchise taxes. Last year, the Governor introduced a wide-ranging government reorganization plan in order to improve efficiencies in state government. As part of the Governor’s Reorganization plan, the Agency will transfer into the Department of Housing and Community Development and will be under the umbrella of the newly created Business, Consumer Services and Housing Agency effective July 1, 2013. It is not anticipated that the proposed changes will affect the Agency’s statutory independence.

The accompanying financial statements are the statements of the Fund and do not include the financial position or the results of operations of the Agency. As of June 30, 2012, the Agency had total assets of \$8.75 billion and fund equity of \$1.45 billion (not covered by this independent auditor’s report).

The Agency is also authorized to use the Fund to provide mortgage insurance for loans made by the Agency and others which finance the acquisition, new construction, or rehabilitation of residential structures in California. Total risk in-force was \$519.6 million and \$653.9 million at December 31, 2012 and 2011, respectively. Of the insured first mortgage loans outstanding at December 31, 2012, 86.8% have loan-to-value ratios, measured as of the funding date of the loan, greater than 90%.

The Fund’s reserve for loan losses decreased during 2012 as a result of the slight decrease in the number of insured California home mortgage delinquencies. The Fund is currently unrated. In 2012, Moody’s rating of Genworth’s Mortgage Insurance Corporation remained unchanged at “Ba1” and Standard and Poor’s rating remained unchanged at “B”.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Accounting - The Fund is accounted for as an enterprise fund. Accordingly, the accompanying financial statements have been prepared using the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America (hereinafter referred to as “Generally Accepted Accounting Principles”), which differ from statutory accounting practices followed by insurance companies in reporting to insurance regulatory authorities.

The financial statements of the Fund were prepared using generally accepted accounting principles that are applicable to a going concern. Management of the Fund has concluded that there is substantial doubt as to the Fund’s ability to continue to fully meet its designated purpose of paying claims and expenses. The financial statements of the Fund do not include any adjustments that might result from the outcome

of this uncertainty. As of December 31, 2012, the Fund's cash and cash equivalents are not sufficient to meet the Fund's total anticipated cash requirements to pay its obligations over the next twelve months. Management believes that attempts to raise any additional capital will be unsuccessful and does not believe that, under the terms of the agreement with the CHFF, the Fund will be able to draw on the interfund credit agreement (see note 6). Subsequent to that event, the Fund will continue to receive its share of premiums from policies still in force and will use the premiums received along with any other available funds to pay the Fund's obligations on a "first-in, first-out" basis in the order in which the claims are received after paying the monthly expenses of the Fund. Further, management of the Fund is actively managing the Fund and continuously reviewing the reinsurance agreement with Genworth to determine the best course of action for both the expiring (unreinsured) and reinsured books of business.

Accounting and Reporting Standards - The Fund follows the Standards of Governmental Accounting and Financial Reporting, as promulgated by the Governmental Accounting Standards Board (GASB). The Fund has adopted the option under GASB Statement No. 20, which allows the Fund to apply all GASB pronouncements and only Financial Accounting Standards Board (FASB) pronouncements which date prior to November 30, 1989.

Use of Estimates - The preparation of financial statements in conformity with Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Cash and Cash Equivalents - The Fund considers cash on hand and cash on deposit with the State Controller's office other than the investment in the State's Surplus Money Investment Fund (SMIF) to be cash and cash equivalents.

Investments - The Agency invests the Fund's excess cash in SMIF, which represents a portion of the State's Pooled Money Investment Account (PMIA). These PMIA funds are on deposit within the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters, and maximum maturity of investments. Investments in SMIF are recorded at fair value. The Office of the State Treasurer of California issues a Pooled Money Investment Board Report with information on the PMIA's portfolio composition. A copy of that report may be obtained from the Office of the State Treasurer, 915 Capitol Mall, Room 106, Sacramento, CA 95814 or via the internet at www.treasurer.ca.gov.

Deferred Policy Acquisition Costs - The Fund defers certain costs related to the acquisition of new insurance policies and amortizes these costs over the expected life of the policies. These costs are associated with the acquisition, underwriting, and processing of new policies. Deferred policy acquisition costs were fully amortized as of December 31, 2012, compared to \$25,280 as of December 31, 2011.

Other Current Assets - The Fund considers current accounts receivable, equipment, and deferred policy acquisition costs as other current assets. Of the total amount, \$932,968 was current accounts receivable.

Claims Payable - The Fund establishes claims payable for claims received but not yet paid. As of December 31, 2012, the Fund's claims payable were \$31,701,719 and \$1,797,758 for CHFF and other external parties, respectively. The claims payable as of December 31, 2011 were \$10,295,110 and \$476,719 for CHFF and other external parties, respectively.

Reserves for Unpaid Losses and Loss Adjustment Expenses - The Fund establishes reserves for losses and loss adjustment expenses, to recognize the estimated liability for potential losses and related loss expenses in connection with borrower default on mortgage payments. The liability for unpaid losses and loss adjustment expenses resulting from mortgage insurance is an estimate based upon the unpaid delinquent balance on mortgage loans reported by lenders as of the close of the accounting period, estimates of incurred but not reported (IBNR) claims, and historical and expected frequency and loss severity information.

There is a high level of uncertainty inherent in the evaluation of the required loss and loss adjustment expense reserves. Management has selected frequency of claims paid and severity loss ratios that it believes are reasonable and reflective of anticipated ultimate experience. The ultimate costs of claims are dependent upon future events, the outcomes of which are affected by many factors. The Fund's claim reserving procedures and settlement practices, economic inflation, court rulings, real estate market conditions, and many other economic, scientific, legal, political, and social factors all can have significant effects on the ultimate cost of claims.

Changes in operations and management practices may also cause actual developments to vary from past experience. Since the emergence and disposition of claims are subject to uncertainties, the net amounts that will ultimately be paid to settle the liability may vary significantly from the estimated amounts provided for in the accompanying financial statements. Any adjustments that may be material to reserves are reflected in the operating results of the periods in which they are made.

Premium Deficiency - The Fund establishes reserves for a premium deficiency wherein future paid losses and expenses on unexpired business exceed the related premium revenue for such business, along with the current loss reserves. A premium deficiency is therefore recognized in the balance sheet as an accrued liability, recorded as a Premium Deficiency Reserve for the excess amount. The liability for the premium deficiency reserve is an estimate based upon the delinquent balance on mortgage loans reported by lenders as of the close of the accounting period, historical claim payment and loss incurred pattern development, future estimated premium, and future estimated losses on currently performing mortgage loans.

Net Position - Fund net position is classified as invested in capital assets, restricted equity or unrestricted equity. Invested in capital assets represents investments in office equipment and furniture net of depreciation. Restricted net assets represent net assets that are restricted pursuant to the Agency's enabling legislation. Unrestricted net assets represent net assets not restricted for any purpose. There were no restricted net assets at either December 31, 2012 or 2011.

Operating Revenues and Expenses - The Fund's primary operating revenue is derived from premiums earned on private mortgage insurance written. The primary expenses are the expenses associated with the underwriting, acquisition, issuance, administration, and the reinsurance of private mortgage insurance products and policies, as well as the losses associated with these products and policies.

Recognition of Premium Income - Primary mortgage insurance policies are contracts that are generally non-cancelable by the insurer and provide payment of premiums on a monthly, annual, or single basis. Premiums written on a monthly basis are earned as coverage is provided. Premiums written on an annual basis are deferred as unearned premiums and amortized on a monthly pro rata basis over the year of coverage. Primary mortgage insurance premiums written on policies covering more than one year are referred to as single premiums. A portion of single premiums is recognized immediately in earnings, and the remaining portion is deferred as unearned premiums and amortized over the expected life of the policy.

Reinsurance - Effective March 1, 2003, the Fund entered into a reinsurance treaty and administrative services agreement with Genworth. This agreement cedes to Genworth a 75% quota share of the insurance risk for most loans insured by the Fund and provides for certain administrative services to be performed by Genworth. The Fund uses reinsurance to reduce net risk in force and optimize capital allocation.

New GASB Pronouncements - In 2011, GASB issued GASB 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and GASB 65, *Items Previously Reported as Assets and Liabilities*. These statements clarify the reporting for deferred inflows and deferred outflows and other reporting issues in governmental financial statements and re-define the definitions and reporting of assets and liabilities. The requirements of GASB 63 are effective for years beginning after December 15, 2011 and for GASB 65, for years beginning after December 15, 2012. The Fund has adopted GASB 63 during the year ended December 31, 2012. The implementation of this new standard resulted in a change in terminology on the Statement of Net Position for 2012.

3. INVESTMENT RISK FACTORS

There are many factors that can affect the value of investments. Some, such as credit risk, custodial credit risk, concentration of credit risk, and interest rate risk, may affect both equity and fixed-income securities. Equity and debt securities respond to such factors as economic conditions, individual company earning performance, and market liquidity, while fixed income securities are particularly sensitive to credit risks and changes in interest rates. It is the investment policy of the Fund to invest substantially all of its funds in fixed income securities, which limit the Fund's exposure to most types of risk. For the investments in the Surplus Money Investment Fund cost approximates market.

Investments by type at December 31, 2012 and 2011, consist of the following:

	2012	2011
Surplus Money Investment Fund — State of California	<u>\$ 12,000</u>	<u>\$ 26,000</u>

Credit Risk - Fixed income securities are subject to credit risk, which is the risk that an issuer will fail to pay interest or principal in a timely manner or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have credit risk. At December 31, 2012, the Fund does not have any investments exposed to credit risk.

Custodial Credit Risk - Custodial credit risk is the risk that in the event of the failure of the custodian, the investments may not be returned. At December 31, 2012, the Fund did not have any investments exposed to custodial credit. All investments are held by the State of California.

Concentration of Credit Risk - Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing the Fund to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments. At December 31, 2012, the Fund does not have any investments exposed to concentration of credit risk.

Interest Rate Risk - Interest rate risk is the risk that the value of fixed income securities will decline due to decreasing interest rates. The terms of a debt investment may cause its fair value to be highly sensitive to interest rate changes. At December 31, 2012, the Fund does not have any debt investments that are highly sensitive to changes in interest rates.

Effective Duration - The effective duration is the approximate change in price of a security resulting from a 100 basis points (one percentage point) change in the level of interest rates. It is not a measure of time. The Fund's investments are not affected by effective duration.

4. RESERVES FOR UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The following tables summarize the changes in the reserves for unpaid losses and loss adjustment expenses for the years ended December 31, 2012 and 2011. The first table presents reserves on a gross basis (before reinsurance) and the second table presents the reserve on a net basis (after reinsurance). The total net reserve for loss and loss adjustment is reflected in the financial statements.

Gross	2012	2011
Gross reserve for loss and loss adjustment — beginning of year balance	<u>\$ 133,389,854</u>	<u>\$ 187,458,542</u>
Incurred (recovered) related to:		
Provision attributable to the current year	85,157,449	117,987,516
Change in provision attributable to prior years	<u>(14,134,629)</u>	<u>(22,251,701)</u>
Total incurred	<u>71,022,820</u>	<u>95,735,815</u>
Payments related to:		
Current year	(14,749,505)	(21,682,276)
Prior years	<u>(84,806,413)</u>	<u>(128,122,228)</u>
Total payments	<u>(99,555,918)</u>	<u>(149,804,504)</u>
Gross reserve for loss and loss adjustment — end of year balance	<u><u>\$ 104,856,756</u></u>	<u><u>\$ 133,389,853</u></u>
Net of Reinsurance	2012	2011
Net reserve for loss and loss adjustment — beginning of year balance	<u>\$ 35,591,608</u>	<u>\$ 49,596,140</u>
Incurred (recovered) related to:		
Provision attributable to the current year	21,921,908	30,912,318
Change in provision attributable to prior years	<u>(4,027,140)</u>	<u>(5,846,715)</u>
Total incurred	<u>17,894,768</u>	<u>25,065,603</u>
Payments related to:		
Current year	(3,730,522)	(5,563,964)
Prior years	<u>(22,179,064)</u>	<u>(33,506,171)</u>
Total payments	<u>(25,909,586)</u>	<u>(39,070,135)</u>
Net reserve for loss and loss adjustment — end of year balance	<u><u>\$ 27,576,790</u></u>	<u><u>\$ 35,591,608</u></u>

The change in provision attributable to prior year (net of reinsurance) decreased by \$4.0 million for the year ended December 31, 2012 due to a decrease in loan delinquencies from the year ended December 31, 2011, while the change in provision attributable to prior year (net of reinsurance) decreased by \$5.8 million for the year ended December 31, 2011 from the year ended December 31, 2010 is also due to a decrease in loan delinquencies.

Reserves for loss and loss adjustment expenses relate to delinquent loans, net of reinsurance. Such estimates were based on historical experience, which management believes is representative of expected future losses at the time of estimation. As a result of the extended period of time that may exist between the report of a delinquency and claim payment thereon, significant uncertainty and variation exist with respect to the ultimate amount to be paid because economic conditions and real estate markets will change.

5. REINSURANCE

Effective March 1, 2003, the Fund entered into a 75% quota share reinsurance agreement with Genworth to reinsure most (currently, approximately 96%) of the Fund's portfolio. Under the terms of this agreement, the reinsurer will indemnify the Fund for 75% of all losses paid on the insured loans to which the Fund cedes 64.5% of the related premiums. The treaty was amended for loans insured on or after May 1, 2008 to cede 67% of premiums collected and amended again on April 1, 2009 to cede 69% of premiums collected on loans insured on or after that date. However, there are no loans currently ceded at 69%. The Fund's reinsurance agreement typically provides for a recovery of a proportionate level of claim expenses from the reinsurer. The Fund remains liable to its policyholders if the reinsurer is unable to satisfy its obligations under the reinsurance agreement. The amount of earned premiums ceded to Genworth for the years ended 2012 and 2011 was \$7.4 million and \$8.2 million, respectively.

According to the terms of the reinsurance agreement, Genworth's reinsurance is for a period up to the end of the tenth calendar year for each existing book year. Therefore, insurance policies issued in 2003 book year had reinsurance through December 31, 2012. The Agency elected not to renew the reinsurance on the expiring 2003 book. If the reinsurance is not renewed after the expiration date, the Fund receives 100% of the related premiums, pays for 100% of any related claims, and receives Genworth's reserves set aside for the related book year.

6. ARRANGEMENTS WITH THE CALIFORNIA HOUSING FINANCE FUND

Certain administrative and operating expenses charged to the Fund are provided by the Agency. These expenses, initially paid from the CHFF, include office space, business services, legal services, accounting services, information systems support, and human resource support services. The Fund is charged monthly for these expenses and a payable is recorded. For the years ended December 31, 2012 and 2011, total expenses allocated to the Fund by the Agency were \$573,538 and \$733,813, respectively.

As part of CalHFA's Loan Modification Program, Genworth remits pre-claim advance payments to the Fund. The payments received are remitted directly to the CHFF. The total pre-claim advance payments due to CHFF were \$67,487 and \$58,179 at December 31, 2012 and 2011, respectively.

The Agency Board of Directors approved Resolution 03-19 on March 20, 2003, authorizing the Agency to utilize the resources of CHFF to support the mortgage guaranty insurance programs of the Agency in the following two ways: (1) the Executive Director of the Agency is authorized to create one or more supplementary reserve accounts within the Supplementary Bond Security Account of CHFF to indemnify the Mortgage Insurance Fund for losses incurred or to pay claims against the Mortgage

Insurance Fund in connection with loans financed by the Agency and (2) the Executive Director of the Agency may establish an interfund credit agreement by which the Fund may borrow such sums from CHFF as may be required to maintain the claims paying rating of any credit rating service.

Initially, the Agency Executive Director established an interfund credit agreement in the amount of \$100,000,000 in which the Fund may borrow from CHFF as needed for the purpose of paying claims arising out of policies of mortgage guarantee insurance and costs and expenses related to the payment of such claims. The amount by which the fund may borrow was reduced to \$10,000,000 from \$100,000,000 during 2009. Interest rates and repayment terms are determined upon receipt of a request to draw on this credit facility. Pursuant to the terms of the Board Resolution and the interfund credit agreement, the credit line is no longer legally available to the Fund. The credit agreement stipulates that the amount of credit is determined to be an amount necessary to maintain or improve the claims paying rating of the Fund, which at the time was "A+", and such amount shall not impair or adversely affect the Agency credit rating or any CHFF bond credit rating. The claims paying rating of the Fund was "A+" until July 2009 when it was lowered to "BBB" and subsequently fell as low as "CCC-" during 2010. In September 2010, management of the Fund decided to withdraw the rating. Consequently, there is no credit line currently available under the interfund agreement as there is no rating to support and the \$10 million would not resurrect the "CCC-" claims paying rating back to "A+".

7. PENSION PLAN AND POST RETIREMENT BENEFITS

The Fund contributes to the Public Employees' Retirement Fund (PERF) as part of the State of California, the primary government. The PERF is a cost-sharing multiple-employer defined benefit pension plan administered by the California Public Employment Retirement System (CalPERS). CalPERS provides retirement, death, disability, and postretirement health care benefits to members as established by state statute. CalPERS issues a publicly available Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information for the Public Employees' Retirement Fund. A copy of that report may be obtained from CalPERS via the internet at www.calpers.ca.gov.

For the CalPERS fiscal years ended June 30, 2012, 2011, and 2010, the employer contribution rates were as follows:

	Jun-12	Dec-11	Jun-11	Dec-10
State Miscellaneous Member First Tier	18.175 %	18.175 %	17.528 %	19.922 %
State Miscellaneous Member Second Tier	17.025	17.025	16.442	19.622

The Fund's contributions to the PERF for the years ended December 31, 2012, 2011, and 2010, were \$335,203, \$189,984, and \$136,045, respectively, equal to the required contributions for each year.

Required contributions are determined by actuarial valuation using the individual entry age normal cost method. The most recent actuarial valuation available is as of June 30, 2011, which actuarial assumptions included (a) 7.5% investment rate of return compounded annually, (b) projected salary increases that vary by duration of service, and (c) overall payroll growth factor of 3% annually. The overall payroll growth factor included an new price inflation component of 2.75% and a 0.25% per annum real wage inflation assumption.

The most recent actuarial valuation of the PERF indicated that there was an unfunded actuarial accrued liability. The amount of the underfunded liability applicable to each Agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due, are presented in the June 30, 2012, CalPERS CAFR.

GASB Statement 45 requires states and local governments to publicly disclose the future dollar amount of their obligations to pay for Other Postemployment Benefits (OPEB), like healthcare, that are provided to retired employees, including retired public employees. The OPEB is a cost-sharing multiple-employer defined benefit healthcare plan administered by CalPERS. State Controller's Office sets the employer contribution rate based on the annual required contribution of the employers (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed thirty years. The Fund's estimated unfunded OPEB cost were \$595,000 and \$309,440 for the years ended December 31, 2012 and 2011, respectively, and this liability was added to Personal Services in the respective year. CalPERS issues a publicly available CAFR that includes financial statements and required supplementary information for the OPEB.

8. LITIGATION

On June 14, 2002, the Agency filed a complaint in the case of California Housing Finance Agency (CalHFA) v. Hanover California Management and Accounting Center Inc., (HC) et al, Orange County Superior court #02CC10634 (Action). The trial in this matter has concluded and the Agency prevailed on all causes of action. The jury awarded \$6.7 million in damages, prejudgment interest of \$1 million, and finally the jury found that the defendants acted with malice, and awarded total punitive damages of \$1.5 million. The defendants appealed the judgment and the Court of Appeal issued a decision affirming the judgment in full. The decision is now final.

The amounts received from the defendants were \$900 and \$3,750 during the years ended December 31, 2012 and 2011, respectively which is recorded as other revenue in the accompanying Statements of Revenues, Expenses, and Changes in Net Position. To date, the Agency has received approximately \$2.8 million. It is highly unlikely that any additional amounts will be received and as such no gain contingency has been recorded.

Certain other lawsuits and claims arising in the ordinary course of business have been filed or are pending against the Fund. Based upon information available to the Agency, its review of such lawsuits and claims and consultation with counsel, the Agency believes the liability relating to these actions, if any, would not have a material adverse effect on the Fund's financial statements.

9. SUBSEQUENT EVENTS

In January 2013, Moody's lowered the ratings on Genworth from "Ba1" to "Ba2".

Last year, the Governor introduced a wide-ranging government reorganization plan in order to improve efficiencies in state government. As part of the Governor's Reorganization plan, the Agency will transfer into the Department of Housing and Community Development and will be under the umbrella of the newly created Business, Consumer Services and Housing Agency effective July 1, 2013. It is not anticipated that the proposed changes will affect the Agency's statutory independence.

Management has evaluated subsequent events during the period from December 31, 2012 to April 25, 2013, the date the financial statements were available to be issued.

**Independent Auditors' Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial
Statements Performed in Accordance with
*Government Auditing Standards***

Board of Directors
California Housing Finance Agency
Sacramento, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the California Housing Loan Insurance Fund (the Fund), which is administered by the California Housing Finance Agency (the Agency), as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated .

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those

provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "CliftonLarsonAllen LLP". The signature is written in a cursive, flowing style.

CliftonLarsonAllen LLP

Baltimore, Maryland
April 25, 2013



The California Housing Finance Agency does not discriminate
on any prohibited basis in employment or in the admission
and access to its programs or activities.

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